

**THE REAL ESTATE
MARKET IN
BOSNIA-HERZEGOVINA**

**CURRENT STATUS AND
RECOMMENDATIONS FOR
REFORM**

Prepared for



The Office of the High Representative
Sarajevo, Bosnia and Herzegovina
U.S. Agency for International Development
Contract No. EEU-I-800-99-00015-00

Prepared by

Carol S. Rabenhorst
The Urban Institute



THE URBAN INSTITUTE

2100 M Street, NW
Washington, DC 20037
(202) 833-7200
www.urban.org

January 2000
UI Project 06901-001

TABLE OF CONTENTS

EXECUTIVE SUMMARY	iii
Background and Purpose	iii
International Framework for the Property Study.....	iii
Historical Context	iii
The Current Property Market.....	iv
Impediments to Property Market Development	iv
Policies on Refugee Return and Displaced Persons and the Property Market	vi
Recommended Changes and Reforms	vi
Options and Approaches for Achieving Necessary Reforms	viii
 I. INTRODUCTION	 1
Background and Purpose of Property Study.....	1
Methodology	2
 II. INTERNATIONAL CONTEXT	 2
Dayton Peace Agreement	3
Stability Pact.....	3
The European Union.....	4
Commission for Real Property Claims	5
OHR Authority with Regard to Occupancy Rights and Refugee Return.....	6
Lessons on Reform from Other CEE Countries in Transition.....	7
 III. THE PRE-WAR PROPERTY SYSTEM	 9
Legal Interests in Real Property	9
The Housing Stock	9
Financing Acquisition and Development	10
Business Transactions and Practices.....	11
Pre-War Property Reforms	11
The Pre-War Legacy	11
 IV. THE CURRENT REAL ESTATE SECTOR	 12
Existing Market Activities and Practices.....	12
Current Legal and Institutional Framework.....	17
Mortgage Finance	22
Housing Privatization.....	24
 V. SUMMARY OF THE CURRENT SITUATION: WHAT'S WRONG WITH THE PROPERTY MARKET?	 25
Ownership Rights Are Unclear	25
Property Records Are Incomplete and Inaccurate	26
The Urban Land Use and Management System Is Anti-Development	26
The Legal and Institutional Framework for Mortgage Finance Is Obsolete and Inadequate	26

New Owners Will Not Control Privatized Housing	26
Market Actors and the Market Itself Are Not Regulated	27
The Property System Does Not Serve Refugees or Displaced Persons	27
VI. MACRO-ECONOMIC AND FINANCIAL SECTOR ISSUES	27
The Economic System	27
Privatization of State and Socially Owned Assets	28
Privatization of Apartments	28
Reform of Banking Sector	29
Foreign Investment Policy	30
Economic Activities and Growth of GDP	30
Prices and Cost of Living	30
Employment and Income	31
Public Income and Expenditures	31
Foreign Economic Relations	31
Financing and Interest	32
“Gray” Economy	32
Prognosis for the Real Estate Market	32
VII. RECOMMENDATIONS FOR REFORM OF THE PROPERTY MARKET	33
Required Legal and Regulatory Changes	33
Additional Sources of Real Estate Finance	35
Regulation of Market Activities	37
Continuing Assistance for Refugees and Displaced Persons	37
Addressing the Problem of Corruption	37
Financing Reforms	37
VIII. OPTIONS AND APPROACHES TO ACHIEVING REFORMS	38
Reform Implementation Framework	38
Policy Considerations in the Implementation Phase	40
ATTACHMENTS	
A. List of Persons Interviewed for Study	45
B. Documents Collected and Reviewed	47
C. Attendees at Feedback Session on Preliminary Results of Study, September 28, 1999, Ohr, Sarajevo	55

EXECUTIVE SUMMARY

Background and Purpose

The Office of the High Representative requested a team of international experts to conduct a study of the status of real property laws, institutions and transactions in Bosnia and Herzegovina (BiH), and to prepare a report with recommendations on reforms necessary to achieve a real estate sector that functions on market principles. The study and report were to be guided by the goal of increasing available options for exercise of property rights by war refugees and displaced persons.

The team's report covers the following topics:

- The international context for reform of the property sector
- The legal, administrative, and financial context – historical and present
- The volume and types of real estate activities and transactions in the current property market
- A summary of problems impeding market-based functioning of the sector
- Recommendations on reforms needed to accomplish transition to a market based sector
- Preliminary options and approaches to achieving reforms

This report completes Phase One of what is envisaged as a two-part project. It is anticipated that Phase Two of the project will involve the transformation of the Phase One report and its recommendations into a detailed implementation plan.

International Framework for the Property Study

The broad framework for the property reforms underlying this report is found in the Dayton Peace Agreement and the Stability Pact. In addition, conclusions and recommendations herein are intended to bring the property market in BiH in line with requirements and guidelines of the European Union, as well as practices expected of full participants in the increasingly regional and pan-European property market.

Market-based principles should guide BiH not only insofar as it aspires to eventual accession to the EU, but also to facilitate achievement of goals and objectives established by donor countries and agencies that provide substantial assistance with post-war recovery and economic development.

Historical Context

Old Austro-Hungarian and socialist Yugoslav laws continue to provide the legal and institutional framework the today's real property system in BiH. Other countries in Central and Eastern Europe where transition to a market-based real estate sector is

well underway shared the history of obsolete Austro-Hungarian laws and newer but market-distorting socialist laws and practices; however, BiH is distinguished by two additional disadvantages: (1) the massive destruction of property and infrastructure and the displacement of large portions of the population as a result of the recent war, and (2) the Yugoslav system of “social ownership.”

While there was private ownership of real property under socialism, especially for single family housing in less densely populated areas, the pervasiveness of social ownership of residential apartments and business enterprises created a system of property tenure based on occupancy or use rights rather than true ownership, and was one cause of a general failure to maintain the property registration system. These are among the most serious problems to be remedied in the market transition.

The Current Property Market

The property market in BiH operates at two levels: a semi-transparent, official market, and an unregulated “gray” market. Information on both market sectors is largely anecdotal and accurate statistics are difficult to obtain.

The official market is similar to that in other developing or emerging market countries: high-end construction, investment and sales transactions occur, generally between multinational companies, aid agencies and foreign individuals with access to equity or external financing and established legal procedures. Real estate agents exist in major cities and towns, handling mostly residential sales and apartment and office rentals in the official market. They are not licensed or regulated, but operate in a reasonably transparent, competitive environment, given the newness of the market. There is no established system of valuation based on market principles.

The unregulated market is generally comprised of low-cost construction and low-value transactions; most participants are local citizens with limited opportunities for financing or legal protections. Construction permits are often not obtained and land use regulations not observed; transactions are not likely to be registered.

Much of the low end of the market is tied up for a number of reasons. It is awaiting privatization, both residential and enterprise or small-commercial, it may be subject to restitution claims under a law that is not yet written, and it may be subject to competing claims as a result of wartime displacements. Together, these factors currently render a substantial portion of the market too uncertain for commercial investment.

Impediments to Property Market Development

The following are among the most serious impediments to development of the real estate market.



? Incomplete, inaccurate property records. From the early part of the century, property records have not been adequately maintained; some were destroyed during World War Two and many more during the 1992-95 war. Property books often conflict with the cadaster, and usually fail to represent the actual situation in the field.

The 1984 Law on Land Survey and Real Property Cadaster, which would unify the property books and the cadaster under the supervision of municipal offices, could provide a good starting point for reform but has only begun to be implemented. In addition, the cost of registration (property transfer taxes and registration fees) and ethnic factors discourage use of the current system and exacerbate problems of corruption.

? Inadequate urban land use and management system. Some municipalities would like to encourage property market and economic development, often with foreign investment, but they are impeded by a system that can only be regarded as anti-development: the lack of a rational land use and management framework, the practice of transferring occupancy or use rights rather than full ownership, high transaction and utility connection fees and complex and conflicting regulations.

Various restrictions and requirements in the current system which invite corruption, the lack of resolution of the restitution issue, and inability to obtain full ownership rights all discourage potential commercial investment in the property sector.

? Unavailability of mortgage finance. This is a fundamental problem. Ultimately, a real estate market cannot function without institutional lending for commercial development of enterprises and housing and for individual home construction and purchase.

BiH does not now have a functioning system of bank lending with mortgage security for purchase or development of residential or commercial real estate. The laws on mortgage and enforcement of obligations are obsolete and inadequate to support a robust property market. The banking sector as a whole is unsettled because of problems of liquidity and the uncertainties of coming privatization.

? Inappropriate management of privatized housing. Apartment privatization, now underway in the Federation and beginning soon in RS, should increase the volume of official property transactions, which in turn should lead to better information on residential market values and greater use of registration procedures. However, the market in residential apartments and the success of housing privatization itself may be jeopardized by regulations now being adopted by cantonal authorities which prevent the resident owners from taking control of the management of the premises for a number of years.

? Lack of regulation of the market itself. Real estate agents are not commonly used, especially outside the larger cities. There are no regulations, licensing requirements or ethical standards that apply to agents or property valuers. Information on the market, including property availability and values, tends to be anecdotal and incomplete. Sales contracts and reporting procedures are not standardized. Unsophisticated participants rely on barter or unofficial exchanges, which exacerbates problems of the property registration system and prevents many holders of property interests from receiving the full economic benefit of their rights.

Policies on Refugee Return and Displaced Persons and the Property Market

Policies on return of war refugees and displaced persons under Annex 7 of the Dayton Peace Accords are administered by the government of BiH and international agencies and not determined by market mechanisms, nor will the market itself resolve conflicting claims to occupancy or result in eviction of illegal occupants. Protection of property rights, both those based on current post-conflict conditions and on market factors in the future, must be implemented by competent judges and other officials acting under rule of law.

Problems in the functioning of the civil law system, which are apparently rife, are beyond the scope of this report. Nevertheless, a functioning property market can have profound and positive effects on the success of policies dealing with the war displaced. These effects include: giving prospective returnees and displaced persons more information on the value of affected property rights and therefore a basis for making decisions on whether to return or to invest in their properties, and providing additional options for economic use of properties, such as the opportunity to sell or exchange homes to which they do not wish to return.

Regulation of market actors, such as real estate agents, and increased public information efforts could provide guidance and assistance to such persons, and would encourage legal, transparent transactions that are fair to all parties.

Recommended Changes and Reforms

The following changes are needed to establish a market-based real estate sector in BiH. The international donor community should consider these as priorities for future funding and technical assistance, as means to effectuate the change in emphasis from humanitarian aid to economic development assistance, and to help create a self-sustaining market economy.



? Legal and Regulatory Reform

A clear system of ownership and other rights in property should be established. Obsolete forms, such as social ownership, should be abolished. Public and private land owners should be encouraged to transfer true ownership of land or to grant land leases rather than occupancy or use rights to investors and developers.

Urban land use and management laws should be modified. Over-regulation and excessive expenses of property acquisition and development should be eliminated. Developers and investors should be able to acquire ownership of urban land. Infrastructure connection fees should be limited to a reasonable, cost-recovery structure.

New laws to support a market-based mortgage finance system are needed. These include laws on mortgage and on enforcement of obligations and execution of judgments.

Model regulations for management of privatized housing are needed. It is necessary to encourage cantonal and municipal governments to devolve authority for decision-making to the new resident owners in privatized apartment buildings through a legally constituted owners' association.

Entity property laws and tax regulation should be harmonized. Property markets are essentially local in nature and not ordinarily subject to national laws in a market economy. It is necessary to harmonize laws between the entities in Bosnia, however, to satisfy cross-entity demand, particularly for refugees and displaced persons. Transfer fees and property taxes should be reasonable and non-discriminatory.

? Land Records and Cadaster. The 1984 Law on Land Survey and Real Property Cadaster, which would unify the property books and the cadaster, should be implemented and its compulsory aspects enforced. Training and equipment for administrative and supervisory staff will be necessary, whether these functions are carried out under the aegis of municipalities, a more centralized authority or the courts.

? Financing for Construction and Development. Reconstruction of war-damaged buildings has been ongoing, financed and carried out primarily by grants from international governments and NGOs. More recently, international agencies have provided loans and lines of credit for residential reconstruction and small enterprise development. These loan programs should be expanded, with additional funds available on similar terms for repair, reconstruction, extension, or improvement of homes and small businesses, and could be targeted to refugees, returnees and repatriated persons. International donors and development banks should be encouraged to assist with capitalization for such loans.

Additional funding would increase housing market activity and stabilization, which in turn would lead to greater reliance among banks on the security of mortgage collateral, discourage circumvention of the land registration system, and help determine market-based prices and valuation.

Domestic resources for financing purchase, construction and renovation of residential property, such as savings and loan associations, building societies, and targeted state subsidies, are not likely to be appropriate or affordable in BiH at the present time.

? Property Taxation. Sub-entity levels of government in BiH have few options for generating revenue, and rely heavily on sales taxes. Real property is taxed through an acquisition fee at the time of transfer but not on a regular basis after that. Property-based taxes should be considered, to enable local authorities to pay for services and infrastructure development from a renewable tax base and to help provide a data base on property values and market information.

? Market Activity Regulation. Market activities such as real estate brokerage, valuation and appraisal eventually should be regulated, by law or through a self-regulating association, and professional training programs, licensing and ethical standards should be explored. Such programs must be carefully designed, however, to avoid dampening competition among market players.

Options and Approaches for Achieving Necessary Reforms

The final section of the report sets out a number of options and general approaches for accomplishing the reforms necessary to achieve a functioning property market in BiH. It includes a preliminary framework for planning the implementation stage, and discusses several policy issues to be considered in designing during the implementation phase.

It is anticipated that members of the international community and relevant officials will review the report before recommendations are finalized and implementation planning begins.

THE REAL ESTATE MARKET IN BOSNIA-HERZEGOVINA

CURRENT STATUS AND RECOMMENDATIONS FOR REFORM

I. INTRODUCTION

Background and Purpose of Property Study

The Office of the High Representative requested a team of international experts¹ to conduct a study of the status of real property laws, institutions and transactions in Bosnia and Herzegovina (BiH)² and to prepare a report with recommendations on reforms necessary to achieve a real estate sector that functions on market principles. The study and report were to be guided by the goal of increasing available options for exercise of property rights by war refugees and displaced persons.

The report is organized as follows:

- The international context for reform of the property market—Part II.
- The pre-war property system and its legacies affecting the current situation—Part III.
- The current real estate sector, including existing market activities, legal and institutional framework, mortgage finance, and housing privatization issues—Part IV.
- A summary of problems in the sector that impede its functioning in accordance with market principles—Part V.
- A description of the current macro-economic and financial sector context—Part VI.

¹ At the request of OHR, the United States Agency for International Development provided the leader for the team, Carol S. Rabenhorst, a lawyer specializing in real estate market development in transition economies, from the Urban Institute, Washington, DC. OHR contracted with PricewaterhouseCoopers (PwC) of Budapest, Hungary, to provide the other team members. The PwC team members were: Adam Bisits, a real estate lawyer from PwC-Budapest, who coordinated the PwC group; Zarko Primorac and Alexandra Raach of PwC-Zagreb; Victor Orth, Nora Sarlos and Marcella Barganz of PwC-Budapest, and Johann Knollmann of PwC-Hamburg. The study was organized by Ms. Rabenhorst in June 1999; field work in Sarajevo, Banja Luka and a number of other cities in the Federation and Republika Srpska was carried out by the entire team in late September-early October 1999.

² Throughout this report, the state of Bosnia and Herzegovina is abbreviated as BiH. Unless otherwise specified, this refers to both entities, the Federation and Republika Srpska. Republika Srpska is often abbreviated as RS.

- Recommendations for reform of the property market—Part VII.
- Preliminary options and approaches for achieving necessary reform—Part VIII.

This report completes Phase One of what is envisaged as a two-part project. It is anticipated that Phase Two of the project will involve the transformation of the Phase One report and its recommendations into a detailed implementation plan.

Methodology

To prepare this report, a large number of existing materials on the housing and property system of BiH have been reviewed, and many officials and advisors who work in these fields have been interviewed. Materials and interviews are listed in Attachments A and B, respectively.

During the course of this project and in coordination with it, reports and studies on related issues were undertaken by the Commission for Real Property Claims of Displaced Persons and Refugees (CRPC).³ Where appropriate, preliminary findings from that research have been incorporated into this report.

Preparation of this report has also been coordinated with additional studies of related issues in the property sector, including EU Phare research for a Pilot Project on Rural Land and Property Market Development, which shares the broad objective of developing a functioning, transparent property market.

The implementation plan to be prepared under Phase Two of this project will take into account the CRPC studies and the comments and suggestions of other international agencies and groups concerned with developing a real property market in BiH.

II. INTERNATIONAL CONTEXT

The broad framework for the property reforms envisaged by this report were established by the Dayton Peace Agreement and the Stability Pact. In addition, conclusions and recommendations herein are intended to bring the property market in BiH in line with requirements and guidelines of the European Union, as well as practices expected of a full participant in an increasingly regional and pan-European property market.

³ *Real Property Market in Bosnia & Herzegovina and Status of Property Books and Cadaster in Bosnia and Herzegovina*, CRPC preliminary reports, November 1999.



Market-based principles should guide BiH not only insofar as it aspires to eventual accession to the EU, but also to facilitate achievement of goals and objectives established by donor countries and agencies that provide substantial assistance with post-war recovery and economic development, including protection of the rights of war refugees and displaced persons and the enhancement of their options with regard to use of their property rights.

Dayton Peace Agreement

The Dayton Peace Agreement of 1995 (DPA) and subsequent Peace Implementation Council (PIC) conferences set policies and objectives relating to property in BiH that can only be achieved by a real estate sector that functions on market principles. For example, rights to liberty of movement and residence, recognized in both the Constitution of BiH, Annex 4, Art. II, Cl. 3(m), and Annex 6, Agreement on Human Rights, Ch. 1, Art. 1(10), cannot be readily achieved until citizens are able to identify with certainty what property they own or have an interest in, and to use, buy, sell, lease, mortgage or otherwise derive economic benefit from it. These are hallmarks of a functioning real estate market.

DPA focuses on solving the problems of return of war refugees and displaced persons. A market-based property sector can substantially assist in that effort, by creating fluidity in the sector and increasing the options available to holders of property interests, and by regulating property transactions so that they are legal and transparent. Estimates are that there have been some 2.2 million displaced persons in BiH, with rights affecting over 500,000 properties. A strong regulatory and institutional framework is necessary not only to help these persons avail themselves of their rights, but also to handle the many thousands of transactions that will ensue when they are able to do so.

To help ensure implementation of its objectives, DPA grants strong powers to the High Representative to influence the property market by issuing binding decisions. See Conclusions of the Bonn Peace Implementation Conference, 1997, Sec. XI 2 (c).

DPA mandates policies on property that can be best achieved through development of a market-oriented real estate sector. The current property system must be reformed to facilitate those policies through legislative and institutional change, which can be achieved through intervention by the High Representative, if necessary.

Stability Pact

The Stability Pact for South Eastern Europe (Cologne, June 10, 1999; signed in Sarajevo July 30-31, 1999) provides further support for property market reforms in BiH. As a party to the pact, BiH pledges *inter alia* to combat corruption, to establish an

independent judiciary, to create “vibrant market economies markets open to private sector investment diversified ownership” and to ensure the safe and free return of refugees and displaced persons (para. 10).

The Stability Pact is understood to have a regional mandate and does not involve itself in matters within the domestic jurisdiction of a state, so it does not appear appropriate at this stage to place property market reform on the agenda a Stability Pact Working Table. However if reform takes on a regional aspect, then assistance from the Working Tables or any other processes of the pact might be considered.

The European Union

The European Union does not impose specific requirements on member nations or aspiring members with regard to the property sector. It does, however, provide useful guidelines and disseminates information about European practices that can provide models for reform in BiH.⁴

The European Commission White Book of May 3, 1995, on association agreements with formerly socialist Central and Eastern European states, has limited requirements regarding the property sector in associating states: a minimum standard for protection of intellectual property, and the liberalization of tele-communications markets. There are no specific requirements regarding ownership structure; such a requirement might not be lawful in the light of broad rights to control domestic property markets granted to members under Art. 222 of the Treaty.

Association Agreements with CEE states in transition require that they liberalize their laws on the transfer of real estate and allow for nationals of other EU member states to acquire ownership of land. This reflects the principle of non-discrimination inherent in the entire EU legal framework (cf. Art. 6 EC-Treaty).

It is imperative for any state aspiring to EU accession to establish a clear doctrine of private property rights, to develop a satisfactory level of ownership protection based upon fundamental rights and to abolish any discrimination against foreigners with respect to property rights. With regard to compliance with these standards, BiH law allows free access to property interests to foreign nationals, but fails to provide holders of property interests with sufficient clarity of rights or with access to the full range of

⁴ Art. 222 of the EC Treaty recognizes the broad rights of member states to establish their own framework for property ownership. It provides that the “Treaty shall in no way prejudice the rules in member states governing the system of property ownership.” Art. 3a of the Treaty refers to a market economy and free competition. Art. F (2) of the EC-Treaty also confirms fundamental rights guaranteed by the European Convention on Human Rights. Art. 1 of the amendment protocol to the ECHR explicitly guarantees private property rights. The European Court of Justice has jurisdiction over development of a doctrine of European fundamental rights, including the freedom of private property.



economic benefits of holding property rights that would be available in a functioning property market.

Commission for Real Property Claims

DPA established the Commission for Real Property Claims of Displaced Persons and Refugees (CRPC) to receive and decide claims from those involuntarily dispossessed of real property since April 1, 1992. CRPC decisions may award return of property or just compensation for its loss. Annex 7 of DPA gives CRPC these powers:

- To determine the value of real property according to fixed rates, Art. XII, Cl. 4
- To issue final decisions and effect transactions necessary to transfer or assign title, mortgage or otherwise dispose of property with respect to which a claim is made, or which is determined to be abandoned, Art. XII, Cl. 7
- To lease or sell property for which compensation has been given, Art. XII, Cl. 5
- To make rules and regulations consistent with DPA as may be necessary to carry out its functions, in conjunction with domestic laws on property rights, Art. XV

As of mid-September 1999, CRPC has received some 200,000 claims or applications for decision, mainly on residential property, including socially owned apartments, and has issued 55,000 decisions on ownership rights. It plans to process the remaining claims at the rate of 7,000 decisions a month.

CRPC decisions may confirm ownership or a right to possession, but they are not self-implementing. That is, they do not necessarily result in eviction of unlawful occupants, in updating the land register or in enabling the decision holder to sell or otherwise dispose of the property. Often they are frustrated by local judges, politicians or other officials whose co-operation is needed to implement the decisions. Failure to implement is exacerbated by lack of alternative accommodations for evictees as well as by political considerations. CRPC acknowledges that implementation of its decisions has been slow to occur, and is very difficult to accomplish. There is also a widely held view that CRPC does not effectively exercise the powers of implementation that it now holds.

CRPC is currently preparing two studies: (1) empirical findings on the property market, including preferences of refugees and displaced persons with regard to return and market mechanisms for meeting those preferences, and (2) an investigation of the land registration and cadaster system. Preliminary reports became available in

November 1999 (see footnote 3, above), and final reports are to be completed by the end of January 2000. Results of the CRPC studies should be coordinated fully with the findings in this report and incorporated into the Phase Two implementation plan for the property project.

Art. XVI of Annex 7 provides that after five years, responsibility for financing and operation of CRPC shall transfer from the parties (CRPC and BiH with its two constituent entities, RS and the Federation) to the state of BiH alone, unless the parties otherwise agree. Present plans call for transfer of responsibility and financing to BiH over a two-year period beginning in January 2001.

CRPC procedures need to be strengthened for the agency to have a significant impact on the development of the property market. This can occur by ensuring the conversion of its decisions into secure transactions or marketable titles, and by acting as an independent clearinghouse of data and analysis of the market. CRPC can continue this work after transfer of administration and control to BiH beginning in 2001. As a national institution with wide title-related powers, it can substantially assist in reforming the property identification and registration system.

OHR Authority with Regard to Occupancy Rights and Refugee Return

The broad power of the High Representative to ensure implementation of DPA are illustrated by several recent actions that overruled or modified entity laws on property rights. A Decision issued April 14, 1999 cancelled permanent occupancy rights to apartments granted by the entities during and after the war, and substituted temporary occupancy rights with provisions to better protect the interests of pre-war claimants. The Decision also amended entity laws on abandoned property.

Underlying the Decision was a law passed in the Federation in late 1995, just after DPA was signed, giving displaced persons—then about one million persons—just six days to return to their apartments, and refugees outside the country—about 1.2 million persons—just 15 days to return and claim their properties. Non-returnees lost their occupancy rights and their apartments were reallocated.

Laws in both entities were eventually passed to “cease” or terminate the effect of the 1995 law, but these measures were regarded as inadequate and were amended by the Decision, which annulled court decisions canceling occupancy rights of refugees and displaced persons under the previous law. The Decision also noted that in RS, it was unclear who was entitled to alternative accommodation, who was to give it and what standard the accommodation was to be.



The High Representative's action highlights the following points:

Occupancy rights of refugees and displaced persons can be easily manipulated, often for political reasons. Laws remain unclear on basic matters of residential property and entitlement to alternative accommodation for refugees and displaced persons. The High Representative has strong legislative powers in matters of property rights and title.

Lessons on Reform from Other CEE Countries in Transition

It is useful to consider property sector reforms accomplished in other post-socialist countries in the region to gain insights into legal and institutional changes that might benefit BiH. Germany, Hungary and Croatia were specifically investigated for this report; knowledge of other countries was also used to provide examples. While each has made substantial progress in achieving some of the goals set out for BiH, none of these countries affords an exact blueprint for dealing with the unique problems here, especially those relating to property registration, massive dislocation of the population and war-related property destruction.

Property Rights and Privatization

In *Germany* the re-privatization of publicly owned 'peoples property' (Volkseigentum) in East Germany was entrusted to a single state agency, the Treuhandanstalt. Within this agency, a department, Treuhandanliegenschaftsgesellschaft (TLG), handled real estate as both owner and sales agent, and was obliged to take all market factors into account in order to avoid sell-out prices. A 'deblocking law' (Enthemmungsgesetz) was passed to give entrepreneurs faster and more reliable administrative decisions and to facilitate buying and selling of real estate. There were some incidents of fraud and related problems, but the work of the Treuhandanstalt was generally regarded as successful.

Property expropriated after 1949 was required to be restituted, if possible; otherwise; compensation was paid. After almost ten years, restitution and court proceedings concerning expropriation continue in Germany.

In *Hungary*, privatization of apartments commenced in the 1980s but did not occur on a widespread basis until the mid-1990s. State-owned rental housing was transferred to local governments, who regulated the pricing and sales procedures of apartments to tenants with occupancy rights but were required to allow purchases to be made in installments, with mortgages securing the debt. Privatization is considered successful, with approximately 75-80 percent of former state-owned rental housing now privately owned as condominiums. As to restitution, expropriations during the

communist period were compensated with vouchers, not return of property. This speeded the process and eased its effects on the developing property market.

In both Hungary and Germany, the state of the land registry was not a significant impediment to transfer of privatized property, either for the initial sales to tenants or for subsequent resales, although in Hungary a concerted effort was required to overcome long backlogs in registration of transfers and mortgages resulting from privatization.

In *Croatia*, land registries continue to be somewhat unreliable, probably for reasons similar to those in BiH, but are regarded as improving. A 1996 law provided for compensation for property expropriated during the socialist Yugoslav era. The law was supplemented with normative regulations to deal with the difficult cases of “double nationalization” and development and subdivisions creating successor interests in land entitled to compensation. Croatia’s experience with a new enterprise law is also instructive in that it shows that a period of up to two years is required to put in place the infrastructure to implement the law, including expert judges, notaries public and lawyers.

IMPORTANT LESSONS: To plan implementation of reforms in BiH, the Croatian experience should be carefully studied because of its many parallels to BiH. Housing privatization will be pervasive, but will place burdens on the already dysfunction property registration system. Restitution should not be permitted to impede other reform measures because it is a lengthy, complicated and potentially politically divisive undertaking.

Mortgage Law Reform

Mortgage law reform is especially important to property market development because of its relationship to increasing mortgage lending by banks. Many other former socialist countries in the region provide useful models to follow in adopting mortgage law reforms. In Hungary, recent changes to the Civil Code and a revised Law on Court Procedures clarified and strengthened enforcement and execution procedures.

Reform of loan recovery laws has been successfully accomplished in Poland, Slovakia, Czech Republic, and Croatia. In all these countries, foreclosure can now be accomplished without a court proceeding, restrictions on eviction have been eased and changes in priorities in order of payment from proceeds of execution have improved the position of mortgage lenders.

Residential and commercial mortgage lending is increasing throughout the region. While other forms of security, such as third-party guarantees, are still required in many cases, incidence of foreclosure is increasing, if only as a last resort, and the expedited legal procedures are regarded as an effective deterrent to default.



As economies and legal frameworks improve, more banks are becoming interested in mortgage lending, particularly those with foreign bank partners.

III. THE PRE-WAR PROPERTY SYSTEM

Legal Interests in Real Property

Prior to the break-up of the Socialist Federation of Yugoslavia, the real property system in Bosnia was essentially the Yugoslav system. Its main forms of property remain in effect today. They include:

- *Private property*, primarily individual single family houses and small scale businesses, and the land upon which they were built.
- *Socially owned property*, primarily business or manufacturing enterprises which were managed and operated by a commercial entity, and residential apartments which were managed and operated by an enterprise or municipality.
- *Occupancy or use rights*, usually of long term or indefinite duration, held by residents of socially owned housing, socially owned enterprises, some privately owned businesses and firms and certain agricultural land users.
- *State-owned property*, for government institutions such as the police, health services, social welfare, schools and the like, and the land under socially owned properties and privately owned businesses.

Private and socially owned properties, but not the land on which they stood, were alienable under certain conditions and could be subject to a lien or security interest. In practice, however, rights of use, including tenancy rights in apartments, were not easily transferable.

The Housing Stock

The main form of property for most BiH citizens is their dwelling. A large portion of the housing stock is comprised of privately owned single family houses, which are particularly prevalent in rural areas and small towns.

Before the war, there were:

1,065,723	privately owned dwellings	81%
250,033	socially owned apartments	19%
1,315,756	total dwellings	100%

The socially owned housing stock—enterprise or municipality controlled apartment buildings—is concentrated in larger cities. In Sarajevo, apartments account for 56 percent of the housing stock; in the 7 largest urban areas of BiH, they account for 50 percent of the housing stock.

While the social ownership structure was unique to Yugoslavia in Central and Eastern Europe, in general apartments buildings there suffered from the same conditions prevalent in the region—substandard construction (at least by Western European standards) and poor maintenance of common areas and facilities. These factors left many buildings in need of substantial rehabilitation and upgrading, even before the damage and destruction of the war years.

Financing Acquisition and Development

The principal forms of financing acquisition and development of real estate were self-financing, loans from domestic banks, loans from foreign credit institutions and government subsidies and grants.

Self-financing was the most common form of property finance. An enterprise could use its own funds, derived from realized profit and depreciation, for financing its real estate needs. Because enterprises were operating under extremely unfavorable economic circumstances (low efficiency, over-indebtedness, illiquidity), however, their funds usually were inadequate to meet investment needs. In addition, employed citizens contributed through a payroll deduction system to the financing of socially owned housing, whether built by enterprises or municipalities.

Loans from domestic banks represented a significant source of financing for commercial properties. While the banks were nominally socially owned, contractual relations were established between the banks and enterprises. Theoretically, enterprises were to repay bank loans, including contracted interest, but in practice, banks often extended repayment dates and approved so-called revolving credits because of the economic difficulties of the enterprises and because the banks enjoyed high liquidity.

Loans from foreign commercial banks, guaranteed by domestic commercial banks or by the federal or republic governments, were used for borrowing larger amounts. An investment financed by such a loan had to be sanctioned in an official social plan; that is, it had to be approved by the appropriate state body.



Government subsidies and grants were used to encourage development of underdeveloped regions, agriculture, and export.

Housing construction was financed from family savings for privately owned single family housing, from the funds of enterprises providing socially owned housing, or from government grants for state or municipality owned apartment buildings.

Business Transactions and Practices

In theory, enterprises, banks and other business entities in Yugoslavia were free to pursue entrepreneurial activities, and to manage their own business affairs. In fact, certain political mechanisms directed the operation of virtually all commercial entities.

Until 1974, enterprise activities were controlled by rather rigid social plans. Social planning continued after this date, but the plans were somewhat more flexible and less centrally directed. As a result, enterprises, including banks, were free to allocate basic income, salaries and profits, and to set prices, but because they used socially owned assets for their operations, their activities were regulated and subject to political influence. For example, workers' councils theoretically were empowered to select the managers and directors of their enterprise, but as a practical matter their decisions were based on political considerations.

Pre-War Property Reforms

The economic system of the former Yugoslavia underwent periodic reform, although always adhering to basic principles of central planning. Just before the outbreak of war in 1992, a fairly comprehensive plan of economic reform was drawn up with the aim of establishing a free market economy. A Law on Enterprises and a Law on Banks were passed, with the intention to initiate mass privatization of these structures. As a first step, internal shares were created for distribution to current and former employees. Other reforms of governmental institutions, regulatory mechanisms, ownership systems and company management were conceived but not implemented due to the war.

The Pre-War Legacy

The limited extent of activity in the pre-war property market can be summarized as follows:

- There was a very limited market for residential dwellings and small businesses.

- Transfer of use or occupancy rights was possible but occurred only among a small sector of the population. Socially owned companies could also buy, sell or trade apartments or other real property as their needs changed.
- Socially owned enterprises and private businesses participated in a limited commercial property market, but there were few conventional transactions, little private investment and limited access to bank financing.
- Registration of title and other interests in property, such as mortgage liens or use rights, were not commonly used in property transactions.

IV. THE CURRENT REAL ESTATE SECTOR

Existing Market Activities and Practices

General

Today, the property market in BiH operates at two levels: a semi-transparent, official market, and an unregulated “gray” market.

The official market is similar to that in other developing or emerging market countries, where high-end construction, investment and sales transactions occur, generally between multinational companies, donor agencies and foreign individuals who have access to equity or external financing and are accustomed to established legal procedures. The operation of the unregulated market is generally the reverse: low-cost construction and low-value transactions, most participants being local citizens with limited opportunities for financing or legal protections.

In practice, real estate agents work mainly in the official market, but the official market is nascent and unsophisticated. Information on both market sectors is largely anecdotal and statistics are difficult to obtain.

Residential Sector

Private residences for sale or lease are advertised in local newspapers, usually by real estate agents. A large percentage of the socially owned apartments are expected to be privatized; estimates by local officials range from 75 to 95 percent. This could impose a massive burden on the property registration system, not only for initial transfers to those with occupancy rights but also as privatized apartments are re-sold on the market.



On the other hand, the housing privatization law, at least in the Federation, requires non-resident holders of occupancy rights to re-occupy their apartments before they can purchase. In additions to creating issues of equity for the refugee and displaced population, this could have a strong limiting effect on the rental sector and housing mobility, at least until a substantial number of new owners of apartments are able to build or purchase other homes that they prefer to occupy.

Real estate agents and housing officials in Sarajevo, Banja Luka and Tuzla state there is strong demand for additional housing for refugees and returnees and better housing for persons with higher than average income, and weak supply in the government, enterprise and private sectors.

Commercial development of housing appears viable, if assumptions about demand are correct. Very recently, some larger cities have organized construction of new apartment buildings and new attic flats in existing socially owned buildings, with the new flats available for private ownership from the outset. Banks have issued a small number of credits to construction companies, using the apartments as collateral for the loans. Other private commercial and residential developments are under construction with foreign bank financing, with domestic banks acting as correspondents.

Residential construction costs range between 500-1,500 DM/m², with selling price between 1,000-2,500 DM/m², depending on quality of construction.

Generally the number of real estate transactions is increasing from a low during the war years. In the period 1997 to July 1999, purchases, sales and exchanges show a steady increase in most centers, as follows:

Court Certified Purchases (P), Sales (S) and Exchanges (E) of Residential Property

	1997		1998		1999 (through July)	
	P/S	E	P/S	E	P/S	E
Mostar East	7	1	56	6	62	11
Mostar West	52		72		41	
Capljina	49	3	59	2	30	1
Stolac	6		23		6	
Banja Luka	662		381		228	
Prijedor	9		41		69	
Kozarska Dubica	65		76		58	
Gradicka	132	23	264	24	198	11
Siroki Brijeg	0	0	0	0	0	0
Ljubuski	2		6		10	
Bihac	433	0	561	6	1166	8

	1997		1998		1999 (through July)	
	P/S	E	P/S	E	P/S	E
Velika Kladuca	13	0	47	0	75	1
Bosanska Krupa	2	0	16	0	9	3
Sanski Most	63	2	90	8	98	11
Kljuc	2		24		29	

Prices of properties are indicated by the following average prices, based on the above court registered transactions from 1997 through July 1999.

Average Property Prices Based on the Above Transactions

	Apartments (DM/m²)	Houses (DM/m²)
Mostar East	600-800	500-700
Mostar West	900-1600	600-1200
Capljina	600-800	200-600
Stolac	600-800	200-600
Banja Luka	950-1400	350-900
Prijedor	600-850	500-600
Kozarska Dubica	550-800	400-700
Gradicka	900-1200	400-800
Siroki Brijeg	800-1000	300-1000
Ljubuski	350-750	200-400
Bihac	500-900	200-700
Velika Kladuca	400-700	200-500
Bosanska Krupa	300-550	100-350
Sanski Most	300-500	150-450
Kljuc	300-550	200-400

Industrial and Commercial Sector

Land is available on the outskirts of cities in both entities for industrial and commercial development. However, the attractiveness of developing much of the land is limited by the high cost for connection to public utilities, sometimes as high as the cost of acquisition of the land itself, and the poor physical condition or inaccessibility of utilities.

Commercial development of prime sites in large cities is impeded by a one-time positional tax, again usually equivalent to the purchase price, and, in some cases, by



difficulties in aggregating small parcels with different owners, including multiple levels of government, some of which may be subject to restitution claims.

Demand for land in the industrial sector is difficult to quantify because of the new economic and political context in which industry must operate. Privatization of the former socially owned industries will be a significant step toward gauging demand in this sector. It appears likely that large industrial properties can accommodate newly developing industries, and most industrial properties are ripe for new investment,⁵ providing the problems relating to aggregation and acquisition of ownership can be overcome.

At the present time, the commercial property market remains weak. Commercial properties are often well located, but do not meet modern technical and space requirements. Foreign investment has begun, but on a small scale, and some of these investments seem unlikely to succeed. Current commercial investments include: domestic headquarters and branches of foreign companies and agencies, such as insurance companies, embassies, and the like; shopping center development (one, with financing from China, encompasses an area of 40,000 m²); commercial developments for manufacturing or production, including VW, Audi, Coca Cola and Opel, with an aggregate investment value estimated at 5-20 million DM.

Foreign investment is legally permitted but is discouraged by the fact that only occupancy rights, not full ownership, is granted to the developer.

As in the industrial sector, hard data about the commercial market is not readily available. There is a clear need for more complete research on the present level of activity and future prospects.

Effects of Refugee Return Policies

Policies on returning war refugees and displaced persons to their homes, previously discussed in the section on International Context, are administered by the government of BiH and international agencies and not determined by market mechanisms. Effectuation of the policies, including eviction of illegal occupants, requires diligent enforcement efforts not only by the international community but also by competent domestic judges and officials operating within a civil law system. At this point, the legal system is not adequately developed in BiH.

On the other hand, a functioning property market could have a profound effect on the success of policies dealing with the war displaced, by giving prospective returnees and displaced persons more information on the value of affected properties, and thus a

⁵ One estimate is that 77% of industrial equipment has been written off or is obsolete and must be replaced.

better basis for making decisions on retaining or investing in the properties, and additional options for economic use of properties, such as the opportunity to sell, lease or exchange properties to which refugees do not wish to return.

Even with a functioning market, however, many refugees and returnees will need assistance to avail themselves of market solutions because of their lack of experience with real estate. It would be advisable for a centralized, independent agency to provide guidance and assistance to refugees and displaced persons in finding a buyer or seller and engaging in a legal, transparent transaction that is fair to all parties.

Financing Construction and Reconstruction (International Donor Assistance)

Massive efforts to reconstruct war-damaged buildings has been underway in the Federation since 1994 and in RS since 1995, primarily under international governmental and NGO auspices and financed primarily by grants and humanitarian donations. Early projects, now complete, provided weatherproofing and replacement windows for residential properties.

More recently, international agencies and development banks have provided funds for loans and lines of credit through domestic banks for residential reconstruction and small enterprise development. These cost-recovery lending programs provide important experience for participants in the future property market. See further discussion in the "Current Lending and Lines of Credit Activities" section, below.

Valuation

Real property valuation is not regulated in BiH, and there is no local or national body or practice for property valuation. A lending bank may undertake valuation of a property used as collateral for a mortgage loan, with the appraiser from the bank's audit department or may engage a court-appointed appraiser. For some property transactions, outside consultants conduct appraisals for brokers. The appraisers are usually civil engineers who perform this work privately, as "moonlighting."

In international joint ventures, a party is likely to bring in an international expert to conduct a property evaluation. At the present time, however, international practices are of limited utility in BiH. The most commonly used method of appraisal in developed market economies, the comparative approach, would be difficult to use and likely to be inaccurate because of the low level of market activity and because inaccurate prices or rents are sometimes used in contracts to lessen transaction costs if the property is registered. The replacement cost approach, used in established market economies when buildings have been damaged or destroyed, is easier to use but often not appropriate because it fails to take into account important market factors such as location or best use of the property.



The income approach, which analyses the capacity of the property to generate income or other monetary benefit and converts this capacity into market value, is extremely difficult for unskilled persons to use. However, this approach will become increasingly applicable and will lead to realistic market values as evaluation skills increase, at least for the higher levels of the market, because of the presence of foreign lessees and investors

Current Legal and Institutional Framework

Transfer of Property Interests

The two primary property interests in BiH—ownership and occupancy rights—are legally transferable. The first applies to most private homes and small business, the second to socially owned apartments and other socially owned property, and commercial premises on state or municipality owned land.

In accordance with the Law on the Transfer of Property, a valid property transfer requires either a written contract or a decision by an appropriate authority. A contract must have the signatures of the contracting parties authenticated by a competent court. The pre-war Law on Obligations defines the contractual relations between buyer and seller.

Property rights may also be transferred by inheritance, or acquired by prescription, through construction on land not one's own if the user is unaware of owner's rights and after the passage of a legally prescribed period of time (10 or 20 years, depending on circumstances).

Registration of Property, Property Interests and Transactions

To be valid, property interests and transactions must be registered in the property books maintained by the local court. Properties are also recorded in a cadaster, the plan showing the property's physical boundaries, any improvements on the property and the person in possession of the property.

Registration in BiH theoretically is governed by the 1984 Law on the Land Survey and Cadaster, which requires the establishment of a unified property record and cadastral system, but in fact the law has been implemented only in a few places, everywhere else, the property books and cadaster remain separate. Property records are frequently out of date, incomplete or incorrect, and often the property books and the

cadaster conflict as to ownership and other interests in the property.⁶ Many registries were destroyed or displaced during the recent conflict or during World War II. Estimates are that up to 25 percent of the property books of the country may be missing.

Furthermore, registration is widely circumvented to avoid the high property transfer tax—up to 15 percent of the value of the property. Continuing disregard of the requirement to register transactions exacerbates and perpetuates long-standing problems with lost, destroyed or inaccurate records. In Sarajevo, the Deputy Minister of Justice estimates that just 18 percent of sales or other transfers are now registered. In Travnik, officials estimate the rate at 10-15 percent.

Property records in BiH *de facto* are frequently related to buildings rather than to identifiable parcels of land, as intended by the law. Often this is because the owner of a building on state-owned land has long-term occupancy or use rights in the land, which are registered as interests or encumbrances in the property books, with the state continuing to be registered as owner. Subsequent entries relating to such properties are registered in the same way, regardless of changes in use or other interests.

A further problem with use rights is that they relate only to “necessary or required land,” the meaning of which can be quite unclear. This is particularly problematic for buildings that are no longer in use or were destroyed during the war. It is difficult to ascertain what surrounding land and installations are encumbered by rights held by the building’s owner or other persons with unregistered rights.

Property books are usually divided into three sections, for description of the owner, the property and encumbrances or other interests in the property, including mortgages. Registration procedures allow for “subscription,” that is, temporary registration of property rights pending authentication. In addition to ownership and occupancy rights, the following property interests may be registered: co-ownership, joint ownership, a lien or mortgage, usufruct, pre-emption rights and a leasehold with a minimum term of 5 years.

The registry can also be used to note bankruptcy proceedings, litigation, expropriation and the like.

The 1984 law allows the older registration laws from 1930 to continue until new combined single registers are actually in use all over the country. The texts of the 1984 law and the earlier laws of 1930 are not available in every land registry office. The responsible personnel in the offices frequently work on the basis of commentaries or legal traditions rather than of actual code law.

⁶ The recent study on the Status of Property Books and the Cadaster conducted for CRPC estimates that in the 36 municipalities surveyed, the rate of discrepancy between the records and the actual situation in the field ranges between 70 and 95%.



The perception is widely held that the majority of properties in BiH cannot be subject to a legally valid and enforceable sale, and most current occupants cannot validly dispose of their properties, because of inadequacies in the registration system.

Land Survey

In August 1998, the Co-ordination Commission for Cartography and Geodesy was established to conduct a land survey and provide for modern mapping equipment. A recent report notes the value of national legislation, regulation, standards and education on surveying, and recommends modern legislation and practices for surveying issues.⁷

Urban Land Use and Management

Urban land use is controlled by a complex system of planning and allocation. Most knowledgeable persons regard the decision-making framework for urban land management as far too slow and complex, leading to delays, uneven application of regulations and opportunities for corruption.

The planning system currently operates at three levels:

- 1) A national spatial plan allocates land for construction, forestry and agricultural use.
- 2) Municipal and cantonal regulations allocate construction land for industrial, residential and public use.
- 3) Local zoning schemes define permissible siting, height limitations and use restrictions for specific parcels of property.

Not all municipalities have adopted urban plans or complete regulatory schemes for land management. A proposal for development in such places requires the municipality to anticipate plan requirements for the site, and allows for corrupt practices to fill the void. In Banja Luka, for example, there has been a draft urban plan for the city since before the war; the urban plan in force dates from 1973. Most of the land there is owned by the city, which enables the city to influence all property investment and leads to *ad hoc* decision-making.

⁷ *Pre-feasibility Study for a Master Plan for the Surveying Sector in Bosnia-Herzegovina*, (para 7.2.2), prepared by Swedesurvey, February 1999.

A few larger cities are attempting to rationalize their land use and planning to encourage development. In Tuzla, a new regulation on urbanism under consideration will give the local ministry of physical planning and the environment additional authority over land use. Recently, the Tuzla municipality has made available land for new apartment construction (Lakavic Housing Project) and has allocated use rights for craft workshops in a designated site.

In Sarajevo, the City Development Institute exerts another form of control over development sites through a complex application process and assessment of fees for infrastructure connection. The City of Sarajevo owns some 5 percent of land there, and the Institute appears to encourage development on this or other socially owned land by disposing of use rights on terms of a 30 percent down payment with the balance due over the next ten years in equal installments.

To acquire a land use permit, a developer must pay a fee or “positional tax” to purchase occupancy rights and access to public utilities. In Sarajevo, a fee ranges between 21 and 43 KM per square meter, depending on proximity to the city center; it is paid to the City Development Institute which passes it on to the canton. The Institute also assists with aggregation of small parcels for larger site needs, interceding with owners and interest holders, including those that expect to make restitution claims.

Nonetheless, in large part land use issues are not managed at all. Commercial development on agricultural land throughout the Federation is described as “out of control”; enforcement is deficient and fines for unauthorized development are not paid. Unauthorized petrol stations pose a pollution risk. Some 20,000 houses reportedly have been built around Sarajevo without legal building permits. Construction permits are often not obtained or cover only part of the property because of the practice of understating proposed floor space to minimize fees or taxes charged on a building area basis.

Regulation of the Real Estate Market

Regulation of property transactions takes place primarily through the land registration and land use and management system, both of which are inadequate for market regulation. There is no law or regulation dealing directly with the real estate market or with real estate agents or valuation.

Taxation and Transaction Fees

Real property transaction fees are high enough to impede growth of the market, and may contribute to the problem of non-registration of transactions. The 1995 Decree Law on Real Property Transfer, effective in both entities, sets a maximum property transfer tax of 15 percent of the value of property being transferred. The taxpayer is the person selling real property, with the buyer a joint and several guarantor for the tax



liability. Liability arises upon conclusion of the contract for transfer of property rights. Under Art. 13 of the Law, tax liability should be reported within 15 days from the date of the contract, and the tax is assessed within 30 days from the date the tax liability is reported.

Property transfer tax rates vary considerably among jurisdictions, as shown on the following table:

Posavina Canton	5,5%
Tuzla Cantom	up to 15%
Una-Sana Canton	up to 15%
Zenica-Doboj Canton	up to 15%
Bosnia-Podrinj Canton	15%
Central-Bosnian Canton	5%
Herzegovina-Neretva Canton	5%
West-Herzegovinian Canton	5%
Sarajevo Canton	8% general; 10% for flats/family houses
Herceg-Bosnian Canton	5%
Republika Srpska	3%.

There are also land registration fees defined by cantonal or municipal regulations. These duties usually amount to 50-100 KM per transaction.

A property transfer tax of 15 percent seems very high. By comparison, the property transfer tax in Croatia is 5 percent; in Germany, it is 3 percent. In Hungary, the general tax is 10 percent; the residential transfer tax is 2 percent for the first 4 million HUF (about 16.500 USD) and 6 percent for the additional value. The high tax in BiH prompts evasion and discourages registration, furthering the problem of inaccurate and incomplete property records. It also may encourage corruption. A practice was reported of the tax being reduced by the taxation officer who splits the difference between the official or market value and a lower contract value with the taxpayer. The variability of the tax may also encourage "canton shopping," discouraging development in areas where taxes are particularly high.

Other taxes in BiH include personal income tax, imposed on wages and salaries, income from self-employment and property; corporate income tax; excise duties; and sales tax. Personal income tax of 15 percent on basic income and up to 50 percent on additional income is not so high as to draw money away from investments. Corporate income tax of 30 percent is reasonable by European standards.

The comparatively low personal and corporate income tax rates may leave room for an additional equitable tax on property without distortion of the real estate market. Consideration should be given to an annual property tax as a replacement for the high transfer tax. Alternatively, the maximum transfer tax rate should be lowered.⁸

Indirect Regulation and Controls

The following institutions also influence the real estate market, at least indirectly:

- The Privatization Agencies of the Federation and RS and cantonal privatization agencies in the Federation oversee the privatization process, including sales of socially owned businesses and apartments. They also check the validity of payment instruments, particularly those involving frozen or lost bank accounts and past state entitlements.
- The Securities Commission potentially influences the market through regulation of financial activities of socially owned enterprises issuing shares pursuant to privatization.
- Price controls over agricultural products influence the market for rural land.
- Banking Agencies regulate the lending activities of banks, setting requirements for collateral and reserves.

Mortgage Finance

Legal Framework

There is no mortgage law *per se* in Bosnia and Herzegovina. To the extent that loans are secured by real property by agreement between the parties, the controlling law is the Law on Obligations. For such loans, the obligation usually is registered with the court. The Law on Enforcement Procedures provides for enforcement of court orders, and includes procedures for foreclosure or sale of immovable and movable property used to secure a loan.

The current legal framework is simply inadequate to support market-based mortgage finance, both for residential and commercial purposes. Laws relating to mortgages and enforcement of obligations through seizure and sale of immovable used

⁸ See Zorn, et al., *The Potential for a Property Tax in Bosnia and Herzegovina*, Lincoln Institute of Land Policy Working Paper, 1999.



as collateral for a loan pre-date the break up of Yugoslavia, and must be revised to meet market standards.

At the present time, in order for a creditor to receive court authorization to foreclose, the creditor must provide proof of registration of the property in the ownership of the debtor or a document sufficient to register the debtor's ownership rights. If this is not possible, the creditor must initiate a separate legal proceeding seeking a court declaration that the debtor is the owner. In other words, the creditor must resolve any issues of unregistered title before it can proceed with execution against the debtor. Even if the creditor ultimately succeeds, such procedures can take many years and cost more than the value of the property at stake.

Once the debtor's ownership rights are established, the creditor faces several other problems, including low priority in access to the proceeds of a foreclosure sale. Finally, in the case of residential property the debtor has a right to remain in residence indefinitely, as a tenant of the purchaser. This may prevent a lender or a purchaser in foreclosure from ever taking possession of the collateral. This is important in the context of commercial as well as residential loans, because the borrower's home is often a substantial part of the collateral for loans for business purposes.

The absence of an appropriate legal framework for mortgage lending impedes the ability of banks to make secure loans. This in turn prevents property owners from realizing full economic benefit from their assets. It also deters foreign investment in the banking sector, and in the property market as a whole.

Current Lending and Lines of Credit Activities

A number of banks in BiH are participating in donor and development bank-capitalized lending programs. These important programs are providing banks with experience in loan management, underwriting and enforcement of obligations, including, in a small number of cases, foreclosure on moveable and immovable property. They also provide capital to be on-loaned at more favorable terms than those currently available under regular commercial bank loans, and also emphasize technical assistance and training both in managing the loan portfolio and in business development for the enterprises that qualify as borrowers.

USAID and the World Bank have capitalized bank lending programs, which together account for over 90 percent of the credit line funds available in BiH. These funds are used primarily to support enterprise start-up and development. The EU has funded two lending programs administered by Kreditanstalt für Wiederaufbau (KfW), one for small and medium sized enterprises, and the second for housing construction and repair. The housing program makes medium and long-term loans to families for repair, reconstruction, expansion or improvement of their homes. The target group is

refugees, returnees and repatriated persons, but a large portion of the beneficiaries have been persons who were not displaced by the war. Under this program, there are some 10,000 completed and ongoing reconstruction projects. According to KfW, at least 40,000 additional units in the Sarajevo region alone are vacant and in need of reconstruction to make them habitable.

All these programs use mortgages as partial collateral to secure their loans, but also require other collateral, including personal guarantees and pledge of moveable assets. For the World Bank and KfW programs, the banks accept all credit risk for loans made. Under the USAID program, banks are used as agents and are paid a fee; they do not take credit risk.

Housing Privatization

Management of Privatized Housing

Housing privatization is well underway in the Federation and will start soon in RS. Officials believe that the vast majority socially owned apartments will be privatized.

Housing privatization programs in other countries in the region have succeeded, in terms of the number of participants, improvements in the housing stock through owner-financed renovation projects and citizen participation in democratic decision making through homeowners' associations. Obtaining similar results in BiH is important for a number of reasons:

- Home ownership gives the average citizen a stake in the future of the country and the success of its economy. It is demonstrable evidence that economic transition is underway.
- By creating hundreds of thousands of new homeowners, privatization initiates a broad-based market in residential real estate transactions.
- Housing privatization leads to development of other private entrepreneurial activities and economic sectors, such as construction, manufacture of building materials, maintenance services, and property management, as new owners begin to make long-deferred improvements in the condition and management of the properties.

In other countries, new owners are improving the energy-efficiency of their buildings, repairing or replacing roofs and facades, constructing and selling new flats in the attic space or on top of their buildings. Many of these projects pay for themselves through savings in energy costs or by creating new apartments that the owners' association can sell or rent.



Deficiencies in Current Regulation

Unfortunately, the Law on Privatization of Socially Owned Apartments in the Federation provides no guidance on organization or management of apartment buildings after privatization. Rather, it authorizes the cantons to pass regulations on the operation of housing after privatization. The first such regulation has been passed in Tuzla and is expected to be a model for other cantons. This regulation provides that for a period of three years the new owners will pay a monthly fee to the former owner or seller for maintenance and repair of the common property of the building, and only the former owner can decide how to spend the funds.

The system to be used in Tuzla effectively strips the new owners of the right to take control of and manage their property, which will prevent them from beginning to think like owners rather than tenants. Based on past experience with maintenance and repairs while the buildings were socially owned, conditions in the buildings cannot be expected to improve. A system similar to that in Tuzla, leaving control of common property in the hands of the former owner, has been followed in some parts of Russia and other countries in NIS, leading to poor results in terms of rate of privatization, resident satisfaction and improvements in the properties.

New owners in privatized housing should be authorized to form an owners' association, registered as a legal entity, as soon as possible after privatization. Legal status enables the association to decide how to manage the building and to contract for services on the competitive market.

V. SUMMARY OF THE CURRENT SITUATION: WHAT'S WRONG WITH THE PROPERTY MARKET?

As the foregoing discussion makes clear, the real property market is not functioning in BiH. The following points briefly summarize the basis for this conclusion:

Ownership Rights Are Unclear

While there is a legal framework for private property ownership, years of social ownership have distorted the property system. Commercial development is deterred by the practice of transferring use or occupancy rights rather than true ownership. Future restitution policy, which remains undefined, leaves current transactions subject to future claims and disruptions, further deterring commercial market investments.

Property Records Are Incomplete and Inaccurate

The registration system has been inadequately maintained for many years, partly because of the institution of social ownership. Many property books were destroyed during World War Two and the 1992-95 war.

Property books often conflict with the cadaster, and usually fail to represent the actual situation in the field. The 1984 Law on Land Survey and Real Property Cadaster, which would unify the property books and the cadaster under the supervision a municipal office, has only begun to be implemented. The high cost of registration, through property transfer taxes and registration fees, and ethnic and political factors discourage use of the current system and exacerbate problems of corruption.

The Urban Land Use and Management System Is Anti-Development

Property market development is impeded by an urban land use and management system that lacks a rational regulatory framework, leaving developers subject to complex and contradictory rules on the one hand, and arbitrary decision-making resulting from voids in comprehensive planning on the other. High fees for acquisition rights, utility connections and building permits discourage investment. Various restrictions and requirements invite corruption.

The Legal and Institutional Framework for Mortgage Finance Is Obsolete and Inadequate

The laws on mortgage and enforcement of obligations are obsolete and inadequate to support a market-based property finance system. Incomplete and unregistered ownership records impede real estate lending. The banking sector as a whole is illiquid, undercapitalized, and inexperienced with market transactions; it remains further unsettled because of uncertainties of coming privatization.

New Owners Will Not Control Privatized Housing

The market in residential apartments and the success of housing privatization itself may be jeopardized by regulations now being adopted by cantonal authorities which prevent the resident owners from taking control of the management of the premises for a number of years. This will leave new owners without the power to make decisions to improve their properties, and the condition of the multifamily housing stock will continue to be substandard.



Market Actors and the Market Itself Are Not Regulated

Real estate agents and valuers are not regulated. There are no licensing requirements, ethical standards or reporting procedures. International valuation methodologies are of limited applicability except at the top end of the market. Information on availability and values remains anecdotal and incomplete. Sales contracts are not standardized, increasing transaction costs. Lower-end participants rely on barter or unofficial exchanges, which exacerbates the problems of the property registration system and prevents many holders of property interests from receiving the full economic benefit of their rights.

The Property System Does Not Serve Refugees or Displaced Persons

Refugees and displaced persons cannot return to their former residence with accessible title records. The system does not implement CRPC decisions affirming rights, through eviction of illegal occupants, which requires willing judges and enforcers. A more active market would help re-allocate properties by making alternative accommodations available to evictees, and would increase options for holders of property rights to sell, lease or exchange them for others.

VI. MACRO-ECONOMIC AND FINANCIAL SECTOR ISSUES

The Economic System

According to the Constitution, the following responsibilities for economic and financial affairs rests at the state level in BiH:

- Foreign trade policy
- Customs policy
- Monetary policy
- Financing foreign obligations
- Establishing communication facilities
- Regulation of inter-entity transportation (art. Iii, cl. 1(b)-(e), (h) and (i))

All other economic functions are within the jurisdiction of the entities. The Central Bank of BiH, founded in 1997, is authorized to issue currency and implement monetary policy in the whole state. The Central Bank is not allowed to assign credits to commercial banks.

According to this distribution of responsibilities, the property market is more appropriately governed by entity laws and institutions rather than by those of the state. This is also in keeping with practices in developed markets throughout the world. However, some powers of national state could be exercised to over the property market,

for example, authority over finances for the international obligations might embrace taxes generally, or at least taxes designed to give effect to internationally mandated property rights. (See Art. II, Cl. 3(k) of the Constitution.)

Privatization of State and Socially Owned Assets

In the Federation, laws and supporting institutions for privatization of state owned enterprises and banks were adopted in mid-1998. In RS, laws on privatization of enterprises and banks have been passed, whereas the law on privatization of socially-owned apartments is in the process of preparation. Laws on privatization of state owned enterprises and banks are similar in both entities, although there are some differences with regard to transferring income from privatization.

The basic methods in privatization are:

- Small privatization
- Voucher privatization (medium size enterprises)
- Tenders (public auctions) for large enterprises

Privatization of small enterprises has already begun in both entities. All citizens who were residents of BiH on 31 March 1991 are entitled to privatization vouchers. Previously obtained shares, under the pre-war "Markovic reforms," continue to be recognized in both entities. Privatization of agricultural land and forests is not yet regulated under the privatization laws.

The privatization programs could substantially increase the number of real estate transactions. If the institutional and legal framework is not adequate to support the increase in activity, privatization will be delayed and its success could be jeopardized. Privatization and the development of the property market will go hand in hand.

Privatization of Apartments

The system for privatizing socially owned apartments uses vouchers and entitlements the value of which is determined by claims against the state by soldiers, disabilities, unpaid enterprise and military wages and benefits and a number of other factors. It is generally believed that the voucher an average family receives will be sufficient to acquire ownership of their apartment.

The voucher system will result in broad-based property ownership if the vouchers can be readily converted into possession and ownership. The absence of a functioning land registry and title system may be frustrating, but special registration procedures are included in the housing privatization law to ameliorate this problem. However, the voucher system cannot operate effectively if the voucher recipient also has the burden



of evicting an illegal occupant, or going to court, or having to bribe officials, in order to actually obtain occupancy and ownership.

A voucher expires after two years, and an individual must live in his or her apartment for two years to acquire a voucher. These conditions appear to favor incumbents over refugees and the dispossessed. The conditions attaching to vouchers and the different voucher systems between the entities make them difficult to trade or use between the entities.

At least in part because of these factors, the market values vouchers at just 10-20 percent of face value. The discounted value may also be accounted for by the desire among the average citizen for cash to purchase consumer goods or other items rather than acquire real estate with uncertain rights and value.

As noted earlier, however, experience in cities where housing privatization is underway demonstrates the vast majority of apartments will be purchased. Experience in other countries shows that this should be an important market factor in years to come.

Reform of Banking Sector

The Central Bank of BiH acts as a currency board. This principle guarantees the convertibility of the domestic currency. The Central Bank is prohibited from granting credits to companies or governments in either entity, and cannot grant short-term loans to cover a budget deficit. The domestic currency is the convertible mark (KM), issued at the ratio of 1:1 with the Deutschmark. By the end of 1999, other currencies are to be withdrawn from the financial flow (which will primarily apply to the Croatian kuna and Serbian dinar).

The Central Payment Transaction Bureau is to be reorganized, and payment transactions are to be transferred to commercial banks. There are no non-banking financial institutions in BiH at the present time, but initial efforts are underway to form mutual funds and venture capital organizations.

In both entities, many small banks have been created: 49 in the Federation and 18 in RS. All banks are presently undercapitalized. According to the new regulations, each bank must increase its equity to 5 million KM or undergo liquidation. Special measures have already been taken for 12 banks in the Federation to proceed with liquidation or merger with larger banks. Bank privatization is expected to begin in 2000.

While the banking sector has had little direct role in the growth of the real estate market to date, for reasons discussed above, a stable, convertible currency is an essential element of a robust market, and privatization and reorganization of the banking sector will encourage domestic and foreign investment in the sector.

Foreign Investment Policy

The climate for foreign investment in BiH is largely favorable. The Law on Foreign Investments does not restrict foreign investment in BiH, except in the areas of arms manufacturing and the media. Currency conversion and transfer of profit is also protected.

A complicated multi-level tariff system constrains foreign investment, but there are already proposals under consideration to correct this and provide tax incentives to foreign investors. In addition, the Investments Guarantee Agency (IGF) has been established by the government of BiH to protect foreign investors from political risks.

The few significant foreign investments to date include shoe manufacture, wood processing, construction material production and metallurgy.

Economic Activities and Growth of GDP

In the first part of 1999, industrial production in the Federation increased by only 0.2 percent (9.5 percent for the same period last year). In RS, industrial production has declined by 5.6 percent. While real domestic gross product is increasing by high annual rates, the base on which it is calculated is in fact rather low. It is estimated that real gross domestic product per capita at the end of 1998 was approximately 1,383 USD.

On the whole, economic activity in BiH is increasing, although rather slowly. More substantial economic development is dependant on several factors: resolution of political conflict, reduction of risk, establishment of modern communications, building a transparent legal and tax system, and the return of refugees and displaced persons. Since gross domestic product derives primarily from industry (27%) and agriculture (32%), total economic recovery primarily heavily depends on those two sectors of the economy.

Prices and Cost of Living

Prices in the Federation in the first part of 1999 have been relatively stable, increasing 0.3 percent over 1998. There are some changes in the structure of prices—agricultural product prices are decreasing, and prices for services are increasing. In RS, retail prices have increased 15.7 percent compared to the same period last year.

Living costs in the Federation are relatively stable, increasing by only 1 percent compared to the same period last year. In RS, living costs indicate significant inflation, rising 18.2 percent in the first part of 1999. The greatest change has been in the price of services; rental costs increased by 47.6 percent.



Employment and Income

High levels of unemployment and low wages are serious problems in BiH, slowing down the recovery of the economy as a whole, including the growth of the real estate market. Low net salary, low employment rate and the poor purchasing power of citizens. There has been a small increase (14.2%) in the rate of employment in 1999. The total number of employees is 407,194, whereas the number officially seeking employment is 262,228, of which 42.1 percent are unskilled laborers. In RS, 244,267 persons are employed; 146,247 are unemployed, of which 32.1 percent are unskilled.

Average net salary in the Federation is 372 KM, 13.2 percent higher than the same period in 1998. Average salaries in production are 240 KM, and in government administration 520 KM. In RS, average monthly net salary is 211 KM. Of this, 192 KM net per capita is the average in the economic sector, and 265 KM in the non-productive sphere.

Public Income and Expenditures

Tax rates, forms of taxes and types of government expenditures differ significantly between the Federation and RS. In the Federation, public revenues and expenditures are controlled at both the federal and cantonal levels, whereas in RS a higher level of centralization prevails. In the first 6 months of 1999, RS experienced a deficit of 37.4 million KM.

Foreign Economic Relations

In foreign trade, both entities realize high deficits. For the first 5 months in 1999, the Federation foreign trade deficit amounted to 876 million KM; for RS, 487 million KM. Balance of foreign trade is slowly recovering in the Federation, whereas the position of RS is dramatically worsening, especially since the war in Yugoslavia, the main foreign trade partner of RS.

The total deficit of the current account amounts to 1,503 million KM. It should be emphasized, however, that a great many transactions are carried out outside the banking system and the recording of financial transactions is substantially incomplete.

The Central Bank services the external debt of BiH from specially secured funds. In this period, it paid 64,5 million KM, of which almost 90 percent went to the World Bank (54,42%) and the IMF (33,5%), with the rest to EBRD (4,82%), the London Club (4,0%), Eurotime [ZP], IFAD and other (3,3%).

Gross foreign currency reserves of BiH as of 30 June 1999 amounted to 655 million KM and are constantly increasing.

Financing and Interest

Lack of affordable financing for business investments is one of the largest constraints to recovery of the economy. Total credits allocated to companies amount to 2,470 million KM, of which 1,080 million KM (43.7%) went to non-financial public companies, 1,374 KM (55.6%) to private enterprises and organizations and 16 million KM (0.7%) to non-profit organizations.

Financing is characterized by the following:

- Short term credits (usually 60-90 days)
- Severe liquidity limitations on lending potential
- Rigid control by regulatory bodies of collateral requirements
- Extremely high interest rates, of up to 50% on an annual basis
- Rigidity in banks policies on lending
- Limited range of financial instruments (deposit, credit, accreditive [zp], guarantees and collateral)
- Low capitalization of banks

“Gray” Economy

A substantial volume of business, income and employment in BiH is not officially registered, particularly in construction works, trade, cross-border traffic with Croatia and Serbia and forest exploitation. There are a large number of unregistered workers in building and construction.

Avoidance of taxes, customs duties and social security contributions for unregistered workers results from a lack of organization of enforcement authorities, poor inspection and surveillance and corruption. Not surprisingly, there are no reliable figures on the size of gray economy, but knowledgeable persons estimate it to be as much as 20-30 percent of GDP.

Prognosis for the Real Estate Market

Despite obvious problems in the economic sector, at least insofar as reflected by official data, there are encouraging signs that the economy and financial system of BiH can support a real estate market. These include the presence of a sound currency, a banking sector on course for reform, the absence of penalizing taxes and growing confidence associated with gradual increases in commercial activity.

The market may be modest at first, because of low domestic spending power, but growth should be spurred by privatization, the absence of



restrictions on foreign investment and trade and the attraction of potentially high returns on investment in a transition economy.

VII. RECOMMENDATIONS FOR REFORM OF THE PROPERTY MARKET

The following must be accomplished for the real property sector in BiH to function on market-based principles:

- Reform of the legal and regulatory framework so that it facilitates rather than impedes property transactions.
- Additional financial resources to support transactions in existing residential and commercial properties and commercial market development. *(In the short run, most funds probably will come from international donors and development banks; these funds should be used in accordance with market based principles such as cost recovery.)*
- A domestic institutional financing system capable of supporting purchase and renovation of existing properties and construction and development of new properties.
- Improved mechanisms to address the special needs and enforce the entitlements of refugees and displaced persons.
- Improved market infrastructure, including reliable and knowledgeable real estate agents and valuers, and access to market information for all present and potential participants.

Required Legal and Regulatory Changes

Clear System of Ownership and Other Property Rights

A functioning market requires access to true ownership, not just long term use or occupancy rights in land or other property. With access only to long-term occupancy rights, few developers operating on a commercial market basis will be willing to invest in BiH.

Unified Property Registration and Cadastral System

Under the law passed in 1984, the property books and the cadaster are to be combined and separated from the court system. The unified system should be universal and compulsory, to establish a widespread system of marketable title and to create an information base of property values and activities. The system must be administratively and financially independent of political influences, with competent, well-trained and well-equipped staff.

Rationalized Land Use and Management Scheme

The market must encourage development and investment to meet demand. At the present time, development options are limited by a plethora of confusing and sometimes conflicting land use and management legislation and practice.

Land use and management reform requires the following:

- Local governments should adopt less complex zoning and planning schemes. This involves simplified rules for matters such as maximum height and floor space and site coverage restrictions. Environmental regulations should be reviewed to ensure a level of environmental protection that the market can support.
- Urban land allocation should be subject to local management plans, and should be subject to competitive and transparent tenders.
- Infrastructure fees should be set within the framework of an overall regulatory scheme, according to rules for cost recovery plus a reasonable margin, and an obligation to provide access.

Owner Control of Privatized Apartment Buildings

The new resident-owners in privatized apartments should assume legal and financial control of their properties as soon as they own the majority of units within a building. A legally empowered association of owners should be formed to make decisions about management and operation of the common areas of the property. Legal status is necessary for the association to be able to enforce their decisions among the owners and to enter into contracts for services, maintenance or renovation.

Apartment ownership will give many citizens their first exposure to the transition to market economics, so it is especially important that they are empowered to take control. It will also provide useful lessons in democratic decision making, in the context of what will be their most valuable asset.



New Laws on Mortgage and Enforcement of Obligations

Ultimately, no market-based property system can succeed without bank financing. This will not occur overnight in BiH because banks must first undergo privatization and restructuring, and the economy must stabilize before long-term lending will be commercially attractive. In the meantime, a new legal framework should be established so that the structure is in place when the market is ready to support bank financing.

New laws on mortgage and enforcement of obligations are required to provide lenders with speedy, secure access to collateral in case of borrower default. An administrative, non-court procedure for foreclosure should be adopted, as well as reforms in the order of priority of claims to the debtor's assets to improve the lender's position. Borrowers should be able to use buildings under construction as security for mortgage loans. Legal reform in the region should be carefully examined to identify useful models for BiH.

Harmonization of Entity Property Laws

In several important ways, this general principle underlies all others, for very practical reasons as well as from the standpoint of fundamental fairness and nondiscrimination. A coherent legal framework of property laws will help rationalize cross-entity demand and supply, particularly for refugees and displaced persons. The real estate market cannot flourish unless there are inter-entity and international transactions. If the laws within a country are confusing or internally conflicting, investors will be wary of entering the market. Finally, laws must be nondiscriminatory to meet the standards for accession to the European Union.

Additional Sources of Real Estate Finance

International Agency and Development Funds

Since 1996, international donor community activities in BiH have increasingly shifted from humanitarian relief to economic and financial restructuring programs based on cost recovery models. Approximately 530 million USD has been used in this manner, about 13 percent of the total of 4 billion USD spent on all post-war assistance.

Cost recovery programs support institutional reform as well as the establishment of lines of credit, equity funds and guarantees. Credit lines are regarded as effective means of stimulating economic activity, creating employment and sector growth. Recent experience has proved loan quality and repayment records to be acceptable, particularly if accompanied by well-designed technical assistance programs for lenders and commercial borrowers.

International donors should consider additional funding for cost-recovery programs directed specifically at encouraging development of the property market. This would increase market activity and stabilization. The increased volume of market transactions would help determine prices and value, which in turn would add greater comfort to banks and other lenders and perhaps reduce collateral requirements for mortgage loans.

Capitalization of a property loan fund would increase the supply of available housing and commercial properties, and would also tend to discourage circumvention of the land registration system, since legally registered properties would be at a competitive advantage. It would also facilitate implementation of refugee return decisions by freeing up alternative accommodations for evicted families.

Domestic Sources of Funds

There are no significant sources of domestic real estate financing in BiH. In the short run, particularly while bank privatization and restructuring are under way, it is unrealistic to expect domestic sources to finance real estate loans on a market basis.

In the meantime, international support for real estate financing, with state guarantees, may be required to provide affordable mortgage-secured loans. Throughout the CEE region, donor-financed technical assistance programs have been successful in encouraging interest in the real estate sector among commercial banks, and in training bankers to administer mortgage loans. New loan products with deferred interest mechanisms also have been successfully introduced in Hungary and Poland to make mortgage borrowing more affordable for the general population and to avoid unaffordable government subsidies.

Reforms in the banking sector and in the legal framework for mortgage lending will also encourage foreign banks to invest and partner with domestic banks. Foreign banks and banking joint ventures have led to increased interest in mortgage lending in other countries in the region and to development of capital markets.

Government policies in some other CEE countries encourage construction savings programs to encourage domestic savings which can be used by depository banks to finance housing loans.⁹ However, these programs require generous government subsidies that BiH cannot afford and that would be inappropriate from a policy perspective at this time.

⁹ Hungary, Slovakia, and Poland have instituted contract savings plans based on the German (*Bausparkassen*) and French (*Epargne Logement*) models.



A legal framework for issuance of mortgage bonds has been adopted in Hungary, Poland, Slovakia and Czech Republic. These require not only a strong legal framework for mortgage lending but also bank restructuring and capital market development, both of which are probably a number of years away in BiH.

Regulation of Market Activities

Real estate agents are needed to put buyers and sellers in touch with each other, and to facilitate market transactions. Real estate brokerage is a growing business opportunity, and professional, independent valuers are needed to assure prospective buyers and sellers that prices are reasonable and fairly reflect market value.

Eventually, these activities should be regulated and ethical standards should be set, either through self-regulation under a voluntary or mandatory membership association, or by licensing. Training in international practices and standards would be an appropriate area for international technical assistance.

Continuing Assistance for Refugees and Displaced Persons

Refugees and displaced persons require special assistance to participate in the property market. Exercising their existing property rights, either through returning to former homes or by easier access to the economic value from their property by leasing, selling or exchanging it, requires a better understanding of their property rights and the value of their asset. They may also require continuing assistance with support services for return or voluntary relocation, including access to employment and retraining opportunities.

Addressing the Problem of Corruption

A functioning, transparent property market will ameliorate problems of corruption, by encouraging the use of registries, making market information widely available to the public and opening access to the market to ordinary citizens. Corruption in property registries, court proceedings, transfer taxation, access to building permits and brokerage transactions can be expected to decrease with additional public information, a more active, broad-based market and technical assistance and training programs that accompany donor-financed loan projects.

Financing Reforms

Substantial funds and technical assistance will be required to accomplish the necessary reforms described above. Donor assistance is diminishing as the war-recovery effort in BiH reaches stabilization and domestic economic activity increases.

Major donors and the development banks should be urged, by PIC and other agencies establishing policy for post-conflict recovery, to direct funds to programs to build the property market, not only for capitalizing loan programs but for related legal and institutional reform and development of market infrastructure.

These funds can be an important investment in the future stability of BiH and the region. Property market normalization and development will decrease the need for financial assistance in the future, and will enhance existing efforts to instill the stabilizing benefits of a civil society and economic growth. Benefits will flow to the least advantaged portions of the population as well as the economically sophisticated, especially because of the expected pervasiveness of housing privatization.

A stable market, particularly with a system permitting transfer of full ownership, should be able to support property taxation as an additional source of revenue for local governments. This would offset revenue losses through a lower property transfer tax, and could be used by local governments to generate funds for infrastructure improvements, training and licensing of real estate agents and valuers and additional salary costs for competent, independent registry officials and judges to deal with property matters.

VIII. OPTIONS AND APPROACHES TO ACHIEVING REFORMS

Reform Implementation Framework

Detailed planning for implementation of property market reform is scheduled to occur during Phase Two of this project. At this point, however, it is useful to consider how the recommendations in this report might be effectuated in order to determine their feasibility and how they might relate to the sector as a whole.

It will almost certainly be necessary to separate the implementation agenda into component parts, since it involves national legislation, local legislation, external market regulation and internal market controls which may be voluntary or market driven.

The following is intended as a very preliminary conceptual framework for approaching the reform requirements identified as part of the Phase One study.



Recommendation	Options and Approaches to Implementation
<i>Clarify ownership and other rights in property</i>	
1. Encourage transfer of full ownership to buildings and land rather than long-term use or occupancy rights, except where appropriate to the property or use in question or preferred by purchaser.	<ul style="list-style-type: none"> a. Coordinate studies on property law and transactions (GTZ, CRPC, etc.). b. Review entity & national laws to assure title provisions are clear and facilitate transfers. c. Publicize benefits of exercising property rights to dispossessed, citizens abroad and potential investors.
<i>Encourage lower taxation of property transfers</i>	
2. <ul style="list-style-type: none"> a. Encourage local governments to adopt lower transfer tax rates. b. Examine system of acquisition fees for development rights. 	<ul style="list-style-type: none"> a. Survey property transfer tax rates in various jurisdictions to determine if lower rates encourage registration and generate more revenue in the long run.
<i>Implement reform of property registration and cadastral system</i>	
3. Implement 1984 Law on Unified Property Books and Cadaster, with possible modifications in light of results of CRPC study.	<ul style="list-style-type: none"> a. Increase training, staffing, and equipment for registration. b. Arrange staff visits to well functioning land registries in other countries in region. c. Enforce use of land register by sanctions, incl. Forfeitures and fines. d. Enforce title decisions of CRPC.
<i>Encourage owner management of privatized apartment buildings</i>	
4. Empower new owners to take control of privatized apartment buildings through an owners' association with legal standing.	<ul style="list-style-type: none"> a. Draft model regulations for condominium management by owners' association. b. Allow owners to control building finances and operations by majority vote. c. Considering training in building management for new owners.
<i>Adopt new laws on mortgage and enforcement of obligations</i>	
5. Adopt new laws on mortgage and enforcement of obligations.	<ul style="list-style-type: none"> a. Examine new laws in other countries in transition. b. Establish working group of bankers, judges, lawyers, realtors, etc. to coordinate drafting of reforms, training in new procedures, dissemination of best practices.
<i>Rationalize land use and management system</i>	
6. Prepare model local regulations (land use, land allocation, planning, zoning, subdivision, etc.)	<ul style="list-style-type: none"> a. Obtain model legislation from appropriate countries. b. Consider relationship between environmental laws and development. c. Review legislation on utility connections and pricing.

Recommendation	Options and Approaches to Implementation
<i>Identify new sources of real estate and construction financing</i>	
7. a. Encourage increased funding from international agencies and donor community for cost-recovery based loan programs. b. Consider methods of encouraging mortgage lending with domestic sources of funds (e.g., deferred interest mortgages).	a. Encourage international agencies to extend capital to finance property market loans under cost recovery conditions. b. Research experience in other countries in transition with efforts to encourage domestic savings.
<i>Regulate the real estate market</i>	
8. Consider training and licensing for real estate agents.	Consider establishing institute or association responsible for ethical codes and standards, standardizing forms, maintaining data base of market transactions, publicizing relevant information and regulations, hearing grievances related to professional conduct.
<i>Real estate valuation</i>	
9. Develop professional standards and practices for real estate evaluation.	Establish a governing body for valuation methodology and quality assurance. Institutional support might be available from the International Assets Valuation Standards Committee and TEGOVA, The European Group of Valuers of Assets.
<i>Provide assistance for refugee and displaced persons to participate in market</i>	
10. Assist refugees and displaced persons with gaining and enforcing their property rights.	a. Review ability of CRPC to issue and enforce decisions on property claims. b. Increase options available in terms of gaining economic benefit from sale, lease or exchange of property rights. c. Publicize benefits and options available through exercise of property rights.

Policy Considerations in the Implementation Phase

Using Available Resources

As noted elsewhere in this report, there are a number of existing agencies and institutions, and potentially other mechanisms, that can be used to further the development of a functioning property market in BiH. The feasibility of activating these resources for this purpose should be carefully explored when planning implementation of these recommendations. The input of local officials, market participants and international agencies in identifying and evaluating the use of such institutions to develop the property market will be especially helpful in planning and implementing the reform agenda.



This approach will have several important benefits. It will use available, established financial and organizational resources, and it will avoid the expense and loss of time required to create, train, and regulate new bureaucracies or agencies. This is especially important in a post-socialist, transition economy such as BiH, where it is critical to balance the goals of eliminating wasteful subsidies, decentralizing government authority and increasing democratic participation and decision making, with efforts to encourage free market development.

It is important to avoid the temptation of simply turning these problems over to a special bureaucracy established just for this purpose. This has proved wasteful and ineffective, not only in transition countries but also in established economies, including the United States, and would interfere with activities more appropriately carried out by participants in the market.

Some existing options for participants in property market reform include: CRPC, particularly in light of the expected transition of operational and financial control to BiH; national and local privatization commissions; the association of government finance officers; project offices implementing existing loan programs with cost recovery components; and the like. New associations or working groups will be necessary, for example, for mortgage lenders, realtors, and condominium organizations, but these should be voluntary associations formed in the private sector.

The legislative and administrative authority of OHR is an important tool for economic restructuring, particularly when rights of refugees and displaced persons are involved. It is important to use those powers judiciously, however, especially in light of balancing market development with democratic principles and the essentially local nature of property regulation and management as administered in developed economies.

Testing the Progress of Reform

In planning the implementation phase, demonstration projects can be designed to test the completeness of the reform agenda and the effectiveness of changes as they occur.

As always in the economic development sector, it is important to design projects that use resources that are or will be generally available, and not special subsidies, concessions or protections against risk or competition. Otherwise, the results will not be replicable, and may further distort the market or discourage widespread participation in the future.



ATTACHMENTS



ATTACHMENT A

LIST OF PERSONS INTERVIEWED FOR STUDY

Date	Person/Institution	Property Team attendee(s)	City
23/09/99	<i>Arlanagic-Tanovic G.</i> National Lawyer Judicial Systems Assessment Program	M. Barganz	Sarajevo
23/09/99	<i>Begic M.</i> Geodesy and Property Judicial Office of BiH	A. Bisits	
21/09/99	City Department for Urbanism	J. Kohlmann N. Sarlos C. Rabenhorst	Banja Luka
21/09/99	City Urbanism (Geodesy) Dept.	J. Knollmann I. Hajnal N. Sarlós C. Rabenhorst	Banja Luka
14/09/99	<i>Demaludin M.</i> Deputy of Ministry of Justice	A. Bisits A. Raach	Sarajevo
14/09/99	<i>Demaludin M.</i> Deputy of Ministry of Justice	A. Bisits A. Raach	Sarajevo
23/09/99	<i>Howitt D.</i> OHR Human Rights Dept.	N. Sarlós M. Barganz	Sarajevo
	Imamovic Deputy Mayor of Tuzla	A. Raach	Tuzla
20/09/99	<i>Injac S.</i> Deputy director Banking Agency of Republika Srpska	J. Knollmann I. Hajnal N. Sarlós C. Rabenhorst Z. Primorac	Banja Luka
21/09/99	<i>Jovanovic D.</i> General director Ekvator Bank	I. Hajnal	Banja Luka
21/09/99	<i>Kondic N.</i> Finance minister Ministry of Finance, RS	N. Sarlós Z. Primorac	Banja Luka
20/09/99	<i>Mandic B.</i> Deputy of the Minister Ministry of Urbanism	J. Knollmann N. Sarlós C. Rabenhorst	Banja Luka
	<i>Mujagic A.</i> director Federal Privatization Agency	J. Knollman A. Raach C. Rabenhorst	Sarajevo
20/99/99	<i>Potkonjak M.</i> Deputy director Agency for Privatization, RS	I. Hajnal Z. Primorac	Banja Luka
23/09/99	<i>Puskarevic V.</i> CRPC Legal Expert	V. Orth M. Barganz	Sarajevo
21/09/99	<i>Radovanovic L.</i> Deputy Head of City Economic Department	I. Hajnal	Banja Luka
22/09/99	<i>Ramhorst S.</i> Jogen Emil Engel International Management Group	V. Orth N. Sarlós	Sarajevo



Date	Person/Institution	Property Team attendee(s)	City
	<i>Sestan D.</i> Deputy Minister in cantonal Ministry of Housing	J. Knolmann A. Raach	Sarajevo
	<i>Sestan D.</i> Deputy Minister in Ministry of Housing		Sarajevo
20/09/99	<i>Sljepcevic Z.</i> Executive director Development Bank AD	I. Hajnal	Banja Luka
22/09/99	<i>Wefers P.</i> , <i>Hoftijzer M.</i> OHR Economists	N. Sarlós M. Barganz	Sarajevo
	<i>Zahirovic</i> director Privatization Agency	J. Knollman	Tuzla

ATTACHMENT B
DOCUMENTS COLLECTED AND REVIEWED

VOL. 1

1. ICMPD
Municipality Information Fact Sheet, Trebinje
2. IMG
War-damaged residential buildings & Status on repair/reconstruction and funding requirements
January 1999
3. Conditions for there turn of displaced persons from the European Union – Final report
4. CRPC – Return, relocation and property rights
Sarajevo, November 1997
5. Phare – Rural land and property market development in BiH
ASPU pilot project proposal, August 1999

VOL. II

1. Conditions for the return of displaced persons from the European Union – Final report
2. ASPU Draft Project Proposal, Annex 1
Project counterparts
3. JSAP – Report for the period November 1998 to January 1999
4. Privatization news – January-April, 1999
March-April-June-July-August-September October, 1998
5. UNMIBH – Judicial System Assessment Programme
Report for the period November 1998 to January 1999
6. CRPC – Return, relocation and property rights
Sarajevo, November 1997



7. Data about courts and public prosecutors' offices in Bosnia and Herzegovina:
 - District 1 – Bajna Luka
 - District 2 – Doboj
 - District 3 – Bijeljina
 - District 4 – Trebinje
 - District 5 – Srpsko Sarajevo

VOL. III

1. Third semi-annual Report to the European Commission
Covering the Period of 1 January to 30 June 1999
2. Towers of Sarajevo – A Suitable Housing Model
April-May 1999
3. The World Bank – Resident Mission Bosnia and Herzegovina Directory, May 1999
4. Assessment of mortgage finance, privatized housing management, and implementation of the law on privatization of apartments, and recommendations for legal and policy changes in the federation of Bosnia-Herzegovina, Prepared by Carol S. Rabenhorst, December 1997
5. Bank privatization unit – Ministry of Finance
Federation of Bosnia and Herzegovina
Information memorandum
6. BiH, Housing Construction Loan Programme: A proposal for additional EU-Funding
ECU 20,0 million
Programme Appraisal Report
7. BiH, Housing Construction Loan Programme
ECU 15,0 million
Programme Appraisal Report

VOL. IV

1. *Decree On proclaiming the law on agricultural land*
2. Commission for real property claims of displaced persons and refugees (CRPC)
Dayton Peace Agreement – Annex 7: Return, relocation and property rights
Sarajevo, November 1997



Data About Courts and Public Prosecutors' Offices in Bosnia and Herzegovina:

- Canton 10-Herzeg-Bosnia Canton
- Canton 8-West-Herzegovina Canton
- Canton 9-Sarajevo canton
- Canton 7-Herzegovina-Neretva Canton
- Canton 6-Central Bosnian Canton
- Canton 4-Zenica-Doboj Canton
- Canton 5-Bosnia Podrinje Canton-Gorazde
- Canton 3-Tuzla-Podrinje Canton
- Canton 1-Una Sana Canton
- Canton 2-Posavina Canton

3. SFR/ 20/78 – Article 140-187
4. Unlawful Practice of the Administrative Organs vis a vis Issued Decisions Since July 5, 1999 in the Strict Sense of the Law
5. Private Property Issues in the Strict Sense of the Constitution of the Federation of BiH and the Law of Basis of Ownership Relations
6. Legal backgrounds of socially owned flats and private property
7. Commission for real property claims of displaced persons and refugees
Dayton Peace Agreement – Annex 7: Decisions on property laws, 14 April 1999
8. CRPC – Focus on new property and housing laws, 5 June 1998
9. Law on the basis of ownership relations – Official Gazette of RBiH No.37/95, October 2, 1995
10. Law on sale of apartments with existing tenancy right – Sarajevo, November 1997

VOL. V

1. Policy study on selected issues affecting property in Bosnia and Herzegovina: The real property registration and cadaster system and assessment of the feasibility of a property fund, 06.1999.
2. Office of the high representative in Bosnia and Herzegovina, Federation of Bosnia and Herzegovina; OHR links to relevant sites – G7/G8 summit, 12.08.1999.

3. The general framework agreement for peace in Bosnia and Herzegovina Agreement on Civilian Implementation; Agreement on inter-entity boundary line and related issues 14.12.1995.
4. Conclusions of the peace implementation conference; 8-9.12.1995.
5. Joint statement on the federation: Statement on the Federation of Bosnia and Herzegovina 18.02.1996.
6. Agreement of the Federation of Bosnia and Herzegovina, 30.03.1996.
7. OHR and refugees/displaced persons – 04.12.1998.
8. Code of practice for reconstruction and repair – 09.1998
9. Summary of conclusions (Bosnia and Herzegovina 1998. self-sustaining structures Conclusions; 10.12.1997.
10. Bosnia and Herzegovina 1997: Making peace work; 04-05.12.1996.
11. Communiqué – Political declaration from ministerial meeting of the Steering Board of the Peace Implementation Council; 30.05.1997.
12. Decisions on Property Laws – Press release; 14.04.1999.
13. Focus on new property and housing laws; 05.06.1998.
14. Investment climate; 16.08.1999.
15. Abandoned property legislation – press release; 09.1996.
16. Briefing notes Property Judiciary Meeting OSCE mission to BH; 22.9.98
17. Election news; 21.9.99 etc.
18. PIC communique; 22.9.99
19. CRPC statistical claims
20. Stability Pact
21. Madrid, Luxemburg PIC
22. EU Treaty provisions



23. Law on the Cessation of the Application of the Law on Abandoned Apartments 03.04.1998.
24. Law on the Cessation of the Application of the Law on Temporary Abandoned Real Property owned by Citizens; 03.04.1998
25. The High Representative's Decision on amendments to the Law on Cessation of Application of the Law on the Use of Abandoned Apartments; 03.04.1998.
26. The High Representative's Decision to Suspend Article 5 of the Federation Law on the Cessation of the Application of the Law on Abandoned Apartments in the Municipality of Drvar; 30.06.1999.
27. The High Representative's Decision amending the Law on Sale of Apartments with Occupancy Right 01.07.1999.
28. The High Representative's Decision amending the Law on Cessation of Application of the Law on Temporary Abandoned Real Property Owned by Citizens; 01.07.1999.
29. Information Sheet on the New Federation Property and Housing Laws; 09.04.1998.
30. Law on the Cessation of Application of the Law on the Use of Abandoned Property; 11.12.1998.
31. The High Representative's Decision on Amendments to the on Law on Cessation of Application of the Law on the Use of Abandoned Property; 13.04.1999.
32. The High Representative's Decision on Amendments to the Law on Housing Relations; 13.04.1999.
33. The High Representative's Decision to Extend the Deadline for Filing Claims to Repossess Socially-Owned Apartments in the Republika Srpska; 15.06.1999.
34. Instruction on the application of Articles 8 through 11 and 15 through 18 of the Law on the Cessation of the Application of the Law on use of Abandoned Property; 08.12.1999.
35. How to claim repossession of your private property in the Republika Srpska; 19.12.1998.

36. Summary of the legal Framework for privatization in the Federation of Bosnia and Herzegovina; 08.16.1999.
37. Explanatory Memorandum; 10.1998.
38. Property Decision; 14.04.1999.

VOL. VI

1. The Constitution of Bosnia and Herzegovina
2. Michigan Journal of International Law
3. Federation Law on Sales of Apartments with Existing Tenancy Right, Sarajevo Nov. 1997.
4. Comments on the Law on Sale of Apartments with Existing Tenure Rights
5. Updated info on Property laws related to Housing – commentary to amendments
6. OHR Decision of May 26, 1999 stat Law on the cessation of the application of the law on abandoned apartments –OHR Draft
7. A property may not be disposed of by authorities of Bosnia and Herzegovina if it was used on April 6, 1992
8. Law in Implementation of the Decisions of CRPC draft – Federation
9. Law in Implementation of the Decisions of CRPC draft – SR
10. Law on the cessation of the application of the law on abandoned apartments – OHR draft
11. Law on amendments to the law on housing relations RS Federation approved
12. Law on policy of foreign direct investment in Bosnia and Herzegovina
13. Law regulating application of law on temporary abandoned real property owned by citizens – OHR
14. Housing law – Federation, Sept. 96
15. Excepts from Law on Expropriation



16. Law on Basis of Ownership Relations, Oct. 2, 1995
17. Ch. 12.:Enforcement on Immovable
Legislative Process of Bosnia and Herzegovina Parliamentary Assembly
18. Supremacy of Bosnia and Herzegovina over its entities
19. KfW brochure Housing Construction Loan Programme



ATTACHMENT C

ATTENDEES AT FEEDBACK SESSION ON PRELIMINARY RESULTS OF STUDY SEPTEMBER 28, 1999 OHR, SARAJEVO

<u>NAME</u>	<u>ORGANIZATION</u>
Helene Holm-Pedersen	OHR
Madeline Garlick	OHR
William Yaeger	USAID
Erna Kerst	USAID
Paul Prettitore	US Embassy
Carla Ferstman	CRPC
Krista McKee-Samson	CRPC
Marc Rapoport	UNHCR
Sansho Ramhorst	IMG
Berndt Heydecke	Team Koschnick
Matthew Newton	Sarajevo Housing Committee
OHR Property Team:	
Carol Rabenhorst	USAID/Urban Institute
Adam Bisits	PwC Budapest
Nóra Sarlós	PwC Budapest
Zarco Primorac	PwC Zagreb